HOWARD & HOWARD

ATTORNEYS

The Pinehurst Office Center
Suite 101
1400 North Woodward Avenue
Bloomfield Hills, MI 48304-2856
Telephone (810) 645-1483
Fax (810) 645-1568

First of America Plaza
Suite 2000
201 East Kennedy Boulevard
Tampa, FL 33602-5829
Telephone (813) 229-1483
Fax (813) 229-1568

Eric E. Breisach Kalamazoo Office Direct Dial: (616) 382-9711

JUN 4 1996

June 4, 1996

<u>Via Hand Delivery</u>
Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, NW, Room 222
Washington, DC 20554

DOCKET FILE COPY ORIGINAL

Re: Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996; CS Docket No. 96-85

Dear Mr. Caton:

Enclosed is an original and six copies of the Reply Comments of the Small Cable Business Association in the above-referenced matter. Also enclosed is a copy to date-stamp and return in the pre-addressed Federal Express envelope.

Very truly yours,

Howard & Howard

Eric E. Breisach

EEB:cm
cc: Nancy Stevenson
David Kinley
Enclosures
\361\eeb\scba\caton\catonimp.603

No. of Copies rec'd 0+6
List ABCDE

Before the

FEDERAL COMMUNICATIONS COMMISSION

Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996	)	CS Docket No. 96-85
	)	
	)	

COMMENTS OF THE SMALL CABLE BUSINESS ASSOCIATION

Eric E. Breisach
Christopher C. Cinnamon
Kim D Crooks
Howard & Howard
107 W Michigan Ave., Suite 400
Kalamazoo, Michigan 49007
(616) 382-9711

Attorneys for the
Small Cable Business Association

TABLE OF CONTENTS

SUMMARY

Following the lead of this Commission last year, Congress incorporated sweeping new provisions to liberate many small cable operators from onerous regulation imposed by the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act"). Although Congress established broad classifications of small systems and small cable operators, it has left to the Commission to determine many specific parameters. The Small Cable Business Association ("SCBA") submits these comments to assist the Commission in closely examining the impact on small cable of various possible courses of action.

Small Business Act Compliance

SCBA encourages the Commission to consult with and seek the approval of the Administrator of the Small Business Administration as required under the Small Business Act. The regulations governing company size limitations and affiliations all define a "small business" and therefore require Small Business Administration approval.

Small Cable Definitions

Small cable's ability to access capital markets has always been a key factor with the Commission when it crafted regulatory provisions for small cable. If not carefully defined, the Commission could make the ability to access capital markets and to receive reduced regulatory burdens mutually exclusive. Such definitions run contrary to the liberating intent of both the Commission and Congress. Although the Commission asks for input on a variety of information, the affiliation and gross revenue provisions are key to promulgation of meaningful implementation rules.

- **Company Size Cap**

  - The company size cap of 617,000 must establish an initial floor that allows qualified companies to retain qualification even if the total number of national cable subscribers decreases.

  - In the alternative, the subscribers to all multichannel video programming providers could determine the size of the company cap

  - Companies that outgrow the subscriber cap should not face rate rollbacks, but rather have their rate increases subject to regulation.

- **Determining Affiliations**

  - Classify investments as either passive or active based on the historical involvement of the investor in cable system operations

  - Passive investments should never give rise to an affiliation, regardless of the ownership percentage.

  - Active investments should constitute an affiliation only if the investor has more than 50% voting control or exercises de jure or de facto control.

- **Measuring Gross Revenues Of Affiliates**

  - The Act does not require aggregation of affiliate revenues.

  - The Act excludes the gross revenue of the operator. If the Commission includes this revenue, it will preclude companies with more than 250,000 subscribers from use of the provisions Congress intended for companies with up to 617,000 subscribers.

- **Measuring Franchise Size**

  - The franchise is the relevant area of measure to determine qualification for small cable relief.

  - The equivalent basic subscriber is the relevant unit of measure to ensure consistency with other Commission measures.

Effective Competition

The Commission's new requirement that comparable programming will require provision of local off-air programs not only severely restricts the statutory provision, but will make it virtually impossible for small cable to efficiently ascertain whether programming is "comparable."

Cable-Telco Buy-Outs/Joint Ventures

The Commission should establish procedures and presumptions to facilitate joint ventures and buy-outs involving small cable. The costs of providing telecommunications services to rural areas is high. In some cases, joint ventures or buy-outs will facilitate the delivery of new telecommunications services to rural areas. Without guidelines and favorable presumptions to create certainty around the waiver process, most smaller entities will be unwilling to expend the time and high cost of seeking such waivers. The Commission should make the opportunity to encourage such combinations where they serve the public interest

Other Implementation Issues

- **Technical Requirements.** Local franchising authorities should no longer mandate specific system technologies.
- **Prior Year Losses.** Provisions governing the recovery of prior year losses should not limit the scope of loss recovery on Form 1230.
- **Uniform Rates.** Deregulated small cable systems should not be subject to the uniform rate requirement.

Before the

FEDERAL COMMUNICATIONS COMMISSION

Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Cable Act Reform Provisions	)	CS Docket No. 96-85
of the Telecommunications Act of 1996	)	
	)	

COMMENTS OF THE SMALL CABLE BUSINESS ASSOCIATION

I. INTRODUCTION

The Small Cable Business Association ("SCBA"), through counsel, files these comments to assist the Commission in its consideration of crucial regulation implementing the provisions of the Telecommunications Act of 1996 ("Act") relating to small cable systems and small cable companies. SCBA is well known to the Commission as a participant and small cable advocate over the past three years in most rulemaking proceedings implementing the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act").

SCBA grew from a grass-roots effort by small operators to cope with the burdens imposed by the Commission's implementation of the 1992 Cable Act From the meeting of small operators in May 1993 where SCBA was spontaneously formed, SCBA has grown into a proactive force, currently having over 350 members.

II. THE COMMISSION MUST COMPLY WITH THE SMALL BUSINESS ACT WHEN ESTABLISHING SUBSCRIBER MEASURE AND AFFILIATION STANDARDS THAT DEFINE A "SMALL CABLE COMPANY".

A. The Commission Attempts to Define a Small Company in This Rulemaking.

Congress established the principal definition of a "small cable company:"

> For purposes of this subsection, the term "small cable operator" means a cable operator that, directly or through an affiliate, serves in the aggregate fewer than 1 percent of all subscribers in the United States and is not affiliated with any entity or entities whose gross annual revenues in the aggregate exceed $250,000,000.[1]

Congress left to the Commission, the important tasks of fleshing out the definition by determining how and when to measure subscribers and to define the relationships that may constitute an "affiliation." These determinations will significantly impact the scope of the definition's applicability and, consequently, the number of affected small cable companies.

B. The Small Business Act Applies to This Proceeding.

The Small Business Act ("SBA") defines a small business as one which is: (1) independently owned and operated; and (2) not dominant in its field of operation.[2] The Commission has generally determined that both cable television operators and telephone companies were not subject to the provisions of the Small Business Act because they were in many cases exclusive providers of services, and if not exclusive, at least dominant.[3]

---

[1] 47 U.S.C. § 543(l)(2)

[2] 15 U.S.C. § 632(a)

[3] *See, e.g., Report and Order,* In the Matter of Regulation of Small Telephone Companies, CC Docket No. 86-467 (Released June 29, 1987), 2 FCC Rcd. Vol. 13 3811 at 3815 and *Sixth Report and Order and Eleventh Order on Reconsideration,* In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, MM Docket No. 92-266 and MM Docket No 93-215 (released June 5, 1995) ("*Small System Order*").

Historically, the Commission has consistently made the determination of dominance at the local level. In this rulemaking, Congress mandates a company size standard measured at the national level. Because the cable industry on a national level is dominated by a few large MSOs,[4] the cable operators potentially impacted by the company size standard are simply not dominant when viewed on a national basis.

The analysis employed by the Commission in the *Small System Order* concluding that the SBA did not apply to that rulemaking is easily distinguished from this rulemaking. In the *Small System Order*, the Commission determined that the SBA did not apply for two reasons. First, as part of the 1992 Cable Act, Congress established a size standard (i.e., fewer than 1,000 subscribers) that precluded application of SBA. The Commission reasoned that providing relief to a greater population of operators than required by statute did not invoke the SBA. Second, the Commission reasoned that "[c]able systems subject to rate regulation are by definition dominant in their field of operation because they do not face effective competition."[5] In this rulemaking, Congress established a size standard that requires Commission rulemakings to establish its precise determination, making the Commission's contention that another statutory size standard had already been determined inapplicable. Further, Congress focused the company size standard at the national level where small cable has no dominance. Consequently, the provisions of SBA apply to this rulemaking.

---

[4]As of December 31, 1995, the eighteen largest MSOs each had more than 617,000 subscribers. These MSOs provided service to approximately 51 million subscribers, or 83% of the national subscribers. National Cable Television Association, *Cable Television Developments*, Spring 1996 ed. at 14.

[5]*Small System Order* at ¶49.

C. The Commission must Seek Approval of Size Standards from the Administrator of the Small Business Administration.

The 1994 amendments to the SBA require that when the Commission promulgates any regulation defining a small business, the following procedures must be followed:

> Unless specifically authorized by statute, no Federal...agency may prescribe a size standard for categorizing a business concern as a small business concern, unless such proposed size standard --
>
> (i) is proposed after an opportunity for public notice and comment;
>
> (ii) provides for determining, -- ..(II) the size of a business concern providing services on the basis of the annual average gross receipts of the business concern over a period of not less than 3 years; ...and
>
> (iii) is approved by the Administrator [of the Small Business Administration].[6]

In this rulemaking, the Commission is establishing a size standard that has not been established by Congress. Simply because Congress mandated that the agency undertake the task does not relieve the Commission from complying with the SBA

The Commission appears to have complied with the SBA requirements to date as it has made the proposed size standard part of a notice and will receive comment The Commission cannot, however, make the determination in isolation. It must seek the approval of its standard by the Administrator of the Small Business Administration [7]

---

[6]15 U.S.C. § 632(a)(2)(C).

[7]SCBA notes that the Size Standards Division of the Small Business Administration filed early comments regarding the size issues involved. These comments, however, were made without considering the record of public comments yet to be made in this proceeding. SCBA has already notified the Administration that its premature comments did not consider all relevant factors and that their reconsideration is essential. Consequently, the Commission cannot rely on those comments as

III. THE COMMISSION MUST CAREFULLY TAILOR THE DEFINITION OF "SMALL CABLE OPERATOR" TO AVOID BARRING ACCESS TO CAPITAL MARKETS.

A. An Over-restrictive Definition of a "Small Cable Company" Will Destroy the Benefits Intended by Congress.

Following the lead established by this Commission in the *Small System Order*, Congress recognized the legitimate need for reduced regulatory burdens on small cable by mandating greater deregulation for small cable companies.[8] Congress left a number of key definitional parameters for the Commission to establish. The Commission must undertake the challenging task of establishing these parameters in a manner that effectuates the relief intended by Congress without creating deleterious side effects.[9] As articulated in detail in these Comments, overly restrictive definitions will block small cable from many sources of capital, crippling not only those systems, but precluding millions of rural subscribers from receiving the enhanced and competitive services that are the hallmarks of the Act.

SCBA's primary concern focuses on the ability of small cable to access capital markets. Overly broad interpretations of the disqualification provisions will render meaningless the relief enacted by Congress, as small cable will face a Hobson's choice: obtain reduced regulatory burden and sacrifice the ability to raise capital or obtain capital but accept large company regulation. SCBA examines these issues more closely below.

---

a surrogate for actual approval by the Administrator

[8]Telecommunications Act of 1996 ("Act") at § 301(c).

[9]*See, Norfolk Redevelopment and Housing Authority v. Chesapeake and Potomac Tel. Co.*, 464 U.S. 30, 36 (1983) ("As in all cases of statutory construction, our task is to interpret the words of th[e] statut[e] in light of the purposes Congress sought to serve . . . ")

B. The Commission must Apply the Subscriber Cap in a Manner That Creates Stability and Certainty.

Only small systems owned by a qualifying small cable company are eligible for greater deregulation under the Act. Congress identified a number of attributes that establish the qualification parameters. One requirement limits the size of the cable operations that the company "directly or through an affiliate, serves in the aggregate fewer than 1 percent of all subscribers in the United States...."[10] The Commission has determined that currently operators serving fewer than 617,000 subscribers meet this requirement.[11] The Commission also proposes adjusting the amount on an annual basis and to use the number of cable subscribers as the national reference amount.

The Commission created the Form 1230 rate regulation structure for those cable companies that "did not have access to financial resources, purchasing discounts, and other efficiencies of larger companies."[12] Although not expressly stated, SCBA understands that Congress replicated the Commission's reasoning when establishing the subscriber limitation.

SCBA has no objection to the derivation of the initial total subscriber amount. SCBA does note, however, that the source cited by the Commission relied on Paul Kagan Associates, Inc. data that SCBA understands reflects **equivalent basic subscriber** data, not **total basic subscriber** data. An accumulation using total basic subscribers would result in an amount greater than 617,000. So

---

[10] 47 U.S.C. § 543(m)(1)(B).

[11] *Order and Notice of Proposed Rulemaking*, In the Matter of Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996, CS Docket No. 96-85 (released April 9, 1996) ("*Order*" or "*NPRM*") at ¶26 (based on total current United States cable subscribers of 61.7 million).

[12] *Small System Order* at ¶28.

long as operators use equivalent basic subscriber counts, however, the reference amounts established by the Commission should provide adequate measures of small cable companies.

1. The Initial 617,000 Subscriber Limit Must Establish a Floor For Measures in Future Years.

For the regulatory relief provisions to have meaningful application, the qualification amount of 617,000 subscribers must establish a floor. Congress knew the approximate size of the cable industry when it enacted this provision. If not, one must assume that the 1% standard lacks a rational basis and is therefore unconstitutional, a presumption a federal agency is not permitted to make under the rules of statutory construction.[13]

The following example illustrates the public policy reasons supporting 617,000 subscribers as the minimum cut-off point.

> **Example**: Cable Company A serving 615,000 subscribers currently qualifies for treatment as a small cable company, presumably because it lacks sufficient size to have economies of scale and access to capital. If the number of national "cable" subscribers shrinks to 61 million next year due to competition from direct broadcast satellite ("DBS") or open video system ("OVS") providers, Cable Company A will no longer qualify for reduced regulatory burdens, presumably because it now has economies of scale and access to capital -- even though neither the company nor the subscribers it serves changed.

---

[13]Federal statutes are to be construed as to avoid serious doubt of their constitutionality. *Crowell v. Benson*, 285 U.S. 22, 62 (1932). "[I]t is a cardinal principle that this Court will first ascertain whether a construction of the statute is fairly possible by [which the question of constitutionality of the statute] may be avoided."

This interpretation makes no sense.[14] Only where the total number of national cable subscribers increases each year will the relief Congress intended not be undermined. If the competitive goals of Congress are met, the number of **cable** subscribers will decrease. One way to avoid a senseless application of the statute that disqualifies previously qualifying companies is to establish an absolute floor for cable companies at 617,000 subscribers. If the number of total cable subscribers drops below 61.7 million in future years, companies serving fewer than 617,000 subscribers will remain qualified for small company treatment.

The same analysis supports raising the floor in future years if the total number of national subscribers increases. Establishing size standards based on a percent of a national total will only create a stable environment where the national total either remains constant or increases. Once a company qualifies for treatment as "small," it should not lose qualification simply because the national index changes.

2. Define "Subscriber" to Include Customers of All Multichannel Video Programming Providers.

The Commission could, in the alternative, define the statutory term "subscriber" to include subscribers to all multi-channel video programming providers. This measure would not result in the aberrations illustrated above and would preserve the intended effect of the statute -- to relieve small companies of unnecessary regulatory burdens.

---

[14]Doubtful provisions of a statute should be given a reasonable, rational, sensible and intelligent construction [*Alexander v. Cosden Pipe Line Co.*, 290 U.S. 484 (1933)] which avoids absurd consequences [*Perry v. Commerce Loan Co.*, 383 U.S. 392 (1966)].

3. Subscribers, the Commission and Cable Companies Benefit From Regulatory Certainty.

Providing certainty that companies with fewer than 617,000 subscribers will maintain eligibility for small company status benefits small cable companies, small cable subscribers and the Commission. The Commission has witnessed the consequences of uncertainty on small cable. Investors and creditors will shun small cable if they have no assurance that a company close to the 617,000 subscriber cut-off will retain qualification from year to year. Financial stability and strength allows operators to provide higher quality and quantity of service to subscribers. Also, companies near a cut-off point that fluctuates from year to year are likely to regularly seek waivers or clarifications about qualification, unnecessarily consuming valuable Commission resources.

C. Companies That Grow Beyond 617,000 Subscribers Should Be Afforded Transitional Regulatory Treatment.

Some small companies will grow beyond the 1% limitation during any given year. The change from deregulation to regulation can be dramatic. Sudden change in permissible revenue streams can cause financial instability and compromise the level and quality of service to subscribers. Some small companies may even halt growth to avoid "crossing the line." These companies should be afforded a smooth transition to regulated status as should other companies that lose small cable status.

1. Operators Should Not Face Rate Rollbacks, Only Regulation of Future Increases.

SCBA suggests that companies that grow beyond the 1% cutoff or become otherwise disqualified be permitted to maintain their basic rates, and limit future increases to regulated amounts. Specifically, operators could maintain their rates at levels existing when regulation takes effect and limit their future increases to those permitted under then existing regulatory schemes. For example,

an operator becoming subject to regulation would be entitled to maintain its rates, but limit its increases to those allowed under either Form 1210 or 1240.

This proposal does no violence to statutory mandates and falls squarely within the Commission's authority to establish the parameters of "reasonable rates".[15] The statutory deregulation of certain rates for qualified systems of small companies demonstrates that Congress was less concerned with the rates they charged and more concerned with the burdens imposed by regulation. Just because a company ventures across the imaginary bright line that divides large and small companies, its rates should not automatically become "unreasonable". Rates permissible yesterday in a deregulated environment are no more burdensome to subscribers under a regulated environment today. Rather, the Commission should focus on ensuring the reasonableness of any future rate increases. Any attempt by operators to significantly boost rates immediately prior to the onset of regulation should be easily spotted by the Commission and actionable under the Commission's evasion enforcement authority.[16]

2. Transitional Rate Mechanisms Avoid Destabilizing Uncertainty and Avoid Creating a Disincentive to Growth.

A transitional mechanism is essential to prevent the destabilizing uncertainty that the Commission has previously attempted to eliminate from the regulatory framework. If potential investors and creditors suspect that a company will grow beyond the 1% limit, and if the impact on rates is uncertain, they will shy away from the investment. Absent transitional relief, the 1% limitation

---

[15] 47 U.S.C. § 543(b)(1).

[16] 47 U.S.C. § 543(h)

becomes a disincentive for small cable companies to grow -- a result that runs contrary to the free market principles of the Act

3. Transitional Regulation is Essential for Companies Growing at the Same Rate as the Industry.

Assuming that the cable industry continues to grow at its historical rate of 2.8%,[17] a company that currently approaches the 617,000 subscriber cap may find itself weaving in and out of regulation if it has a two or three percent growth rate. The prospect of this type of regulatory fluctuation has a particularly destabilizing effect as a small company could find itself in and out of regulation with rates potentially fluctuating each year. This type of fluctuation incites subscriber animosity, confusion and frustration. Transitional treatment for those companies that are only slightly over the annual cap will create the necessary stability.

D. An Overly Broad Definition of Affiliation Will Seriously Restrict Small Cable's Access to Capital.

1. The Act's Definition of "Affiliate" Does Not Govern Affiliations for Purposes of Title VI.

SCBA supports the Commission's tentative conclusion that it must develop its own standards to identify "affiliations" because the Act's 20% standard does not apply to Title VI regulation.[18] The Title VI definition of "affiliation," which predated the Act's definition, states:

---

[17]Computed based on the increase in the total number of subscribers over the past five years using data from *Cable Television Developments*, Spring 1996. National Cable Television Association at 2.

[18]*NPRM* at ¶82.

> the term "affiliate," when used in relation to any person, means another person who owns or controls, is owned or controlled by, or is under common ownership or control with, such person;[19]

The provision in Section 3 of the Act establishes a different definition of "affiliate" that applies "[f]or purposes of this Act, unless the context otherwise requires . . ."[20] SCBA agrees with the Commission that the Act's definition of "affiliate" does not strictly apply to matters under Title VI, since Title VI contains a separate definition of the term that, unlike the Title I definition, does not set a percentage threshold as to what constitutes ownership.[21]

2. The Commission must Consider the Impact on Access to Capital.

The second major qualification for treatment as a "small cable company" restricts the size of the company with which the operator may have a financial relationship:

> [a small cable company may not be] affiliated with any entity or entities whose gross annual revenues in the aggregate exceed $250,000,000.[22]

If a financial relationship with minimal nexus gives rise to an "affiliation," then many major sources of capital will lock their vaults when small cable comes calling. Many larger institutional investors have provided capital in the past, but now such capital could cause small operators to lose the benefits intended by Congress.

Such a result runs contrary to the concerns previously articulated by the Commission. Looking back to the Commission's first attempt at small cable relief, the Commission provided relief

---

[19] 47 U.S.C. § 522(2).

[20] Act, § 3(b).

[21] *NPRM* at ¶82.

[22] 47 U.S.C. § 543(l)(B)(2).

for that group of cable companies that it believed could not access sophisticated capital markets.[23] Access to capital has remained a consistent concern of the Commission, even as it crafted its most recent small cable provisions.[24]

3. The Commission must Distinguish Between Active and Passive Interests.

Investments can and must be divided into two groups: (1) active; and (2) passive. At one end of the spectrum, active investors are owner/operators of cable systems. These owner/operators put their own money into cable and run the day to day operations. Completely passive investors reside at the opposite end of the spectrum. A truly passive investor has no involvement in the operation of the business, either day to day or general policy and strategy development.

The distinction between those who invest to earn a return and those who invest to run a business is crucial to fulfillment of the overall intent of Congress. Congress imposed the affiliation standard to avoid a concentration of media power in certain companies resulting from cross-ownership by an owner involved in the day to day operations of the business.[25] Beginning with the 1992 Cable Act, "Congress made clear its belief that small systems would be in need of administrative

---

[23]Second Order on Reconsideration, MM 92-266, FCC 94-38 (released March 30, 1994) at ¶157.

[24]*Small System Order* at ¶28 ("our relief for small cable entities is aimed at those that do not have access to the financial resources, purchasing discounts, and other efficiencies of larger companies").

[25]The affiliation restriction was introduced in the final draft stages of the compromise legislation. Consequently, no written legislative history exists. SCBA, however, was intimately involved in the legislative process and offers for the Commission's consideration, its understanding of the reasons this restriction was incorporated.

and rate relief as a consequence of the reregulation of the cable industry."[26] Congress greatly enlarged the scope of the systems eligible for relief by allowing up to 50,000 subscribers per franchise area and 617,000 subscribers per company.[27] The only conclusion that one can draw from the consistent direction of Congress is that the purpose of these statutory provisions was to expand relief for small cable. To effectuate the purpose of the statute, the small cable provisions should be interpreted to provide maximum protection for the greatest number of small operators.

Many large institutional investors hold significant equity positions in small cable. The vast majority of these have no involvement in the day to day operations, or even strategic planning; their investment postures are truly passive. Typically, the only involvement these institutional investors have occurs when the investment under-performs and an investor seeks to exit the relationship. Even then, institutional investors typically limit their involvement to issuing instructions to find replacement equity or to sell the company The Commission must recognize the significant difference between an investor who actively involves itself with the running of the cable business and the investor who merely manages its portfolio Deciding whether to exit an investment does not change its passive nature.

Excluding otherwise qualified small cable companies because they have passive institutional investors with more than $250 million of gross annual revenues will substantially shrink the list of qualifying cable companies Such a limiting interpretation is inconsistent with the overarching policy

---

[26] *Small System Order* at ¶26 (referencing the provisions for systems with 1,000 or fewer subscribers).

[27] 47 U.S.C. § 543(l)(B).

objectives articulated by Congress.[28] Passive interests, irrespective of degree, should never trigger the existence of an affiliation.

a. The Ability to Control Operations, If Not Historically Exercised, Should Not Affect the Classification of a Truly Passive Investment.

If an investor has historically treated an investment in a passive manner, the Commission should not consider the relationship with the investor an "affiliation." The nature of how the investor exercises the investment should govern, not technical points of "control" that exist in typical investment agreements. Consequently, the percentage of voting interests or other control factors should not govern if the investment is held in a passive manner. The following example demonstrates this point:

> **Example**: The Cable Management Company ("Management Company") has learned that a prime 20,000 subscriber system is on the market for $48 million. Management Company will establish a separate corporation to buy the system ("Holding Company"). Its equity will come 65% from the Longterm Life Insurance Company ("Insurance Company") and 35% from a private local investor. Insurance Company will have majority voting and equity distribution rights, but it knows nothing about cable operations and knows that Management Company has a good track record. Management Company and Insurance Company are completely unrelated. The system is acquired and the Holding Company enters into a long-term contract for Management Company to operate the system. The management contract may be

---

[28]It is important that the Commission's rules be promulgated with due regard for Congressional policy objectives. *Norfolk, supra*

terminated by Holding Company for cause, however. Because Insurance Company will assume a completely passive posture, its interest and ability to terminate the Holding Company should not give rise to an "affiliation."

The mere fact that an investor has the control to hire and fire the management company bears no relevance on whether an affiliation exists so long as the management company and the investor have no relationship.[29]

b. The Commission Should Establish Guidelines to Identify Passive Investments.

The ultimate test of whether an investment is actively or passively held is determined based on the extent to which the investor **exercises** indicia of control. The Commission can clarify how investments will be classified by issuing guidelines illustrating the factors that will give rise to an affiliation. Nevertheless, contested cases will require the Commission to make case by case determinations. This additional effort is justified, however for without a flexible passive interest provision, a significant number of cable operators would lose the benefit of reduced regulation

SCBA recommends the following affiliation guidelines:

> An investor shall not be considered an affiliate of a cable system for the purposes of small cable company deregulation so long as that investor remains a passive investor. A passive investor is one that
>
> > Has no material involvement in day to day management of the cable company;
> >
> > Has no material involvement in strategic planning for the cable company; and

---

[29]The relevant relationship is that between the investor and the management company. In some cases, the management company may have an investment in the cable system as well. This common investment interest in the cable system does not run to the matter of affiliation and should bear no relevance to the analysis of whether an "affiliation" exists.

Does not exercise direct control over the management of the cable company notwithstanding any rights of termination in any management agreements or foreclosure or control in any loan documents or other investment agreements.

Under this proposed framework, SCBA recognizes that the classification of an investment may change over time. If, for example, an historically passive investor with the right to exercise control begins to involve itself with active day to day management issues, that investor becomes an active investor. Depending on the circumstances, this may cause the Commission to declare that an affiliation exists. Again, the flexibility required by this framework is essential to ensuring that only those relationships necessary to be classified as an "affiliation" are so classified.

4. Active Investments Should Constitute an "Affiliation" Only above 50% or When De Facto or De Jure Control Exists.

The ability to exercise control should determine whether an "affiliation" exists where the investor maintains an active involvement in the operation of the cable business. The Commission has previously established such levels at 20%.[30] This threshold is too low.

a. For Active Investments, the Commission Should Adopt the Small Business Administration Affiliation Regulations.

SCBA encourages application of the affiliation rules established by the Small Business Administration where active investment exist.[31] Under these rules, an affiliation only exists where "A

---

[30] *NPRM* at ¶26.

[31] 13 C.F.R. § 121.401 (copy enclosed as Exhibit A). SCBA's recommendation goes only so far as those rules determining whether investors are affiliated with the company in which they hold an investment. SCBA addresses issues related to common management of individual companies later in these comments.